

Report
of the
Examination of
Federation Life Insurance of America
Greenfield, Wisconsin
As of December 31, 2001

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, Governor
Jorge Gomez, Commissioner

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April 3, 2003

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Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
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Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

FEDERATION LIFE INSURANCE OF AMERICA
Greenfield, WI

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the society was conducted in 1997 as of December 31, 1996. The current examination covered the intervening period ending December 31, 2001, and included a review of such 2002 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the society's operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Growth of Society
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the society's operations accorded a high priority by the examiner-in-charge when planning the examination. Special

attention was given to the action taken by the society to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the society's operations is contained in the examination work papers.

The society is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

Independent actuaries were engaged under a contract with the Office of the Commissioner of Insurance. They reviewed the adequacy of aggregate life reserves, refunds to members, and in force testing. The results of their work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuaries' conclusion.

II. HISTORY AND PLAN OF OPERATION

The society was incorporated April 22, 1913, as the "Polish Federation of America." The society commenced business on February 16, 1915, and the present name was adopted in 1923. Federation Life Insurance of America (FLIA) is licensed as a fraternal benefit society under Chapter 614 of the Wisconsin Statutes. The society has no subsidiaries or affiliates. As a fraternal benefit society, FLIA has no capital stock and exists for the benefit of its members. Membership is limited to persons of Polish or Slavic descent or any person who is married to a person of this descent or any person who is interested in the Polish heritage.

The society writes direct premium in the following states:

Wisconsin	\$257,458	93.56%
Michigan	10,558	3.83
Pennsylvania	7,059	2.57
New Jersey	<u>97</u>	<u>0.04</u>
	<u>\$275,172</u>	<u>100.00%</u>

The major products marketed by the society include ordinary life, single premium whole life, 20-payment life, life paid up at 65, universal life, one and ten-year term life, and deferred and immediate annuities. The major products are marketed through the society's sales manager and lodge secretaries.

The following schedule is a summary of the net insurance premiums written by the society in 2001. The growth of the society is discussed in the Financial Data section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Conventional life*	\$257,482	\$ 0	\$15,063	\$242,419
Universal life	17,690			17,690
Annuities				
Accident and health				
Total All Lines	<u>\$275,172</u>	<u>\$ 0</u>	<u>\$15,063</u>	<u>\$260,109</u>

* Includes \$81,683 of refunds (dividends) used to buy paid-up additions. Conventional life includes whole life, endowment, term, life paid up, and 20-payment life.

The product mix for the society's business as of December 31, 2001, was as follows:

Product Type	In Force	Reserves	Certificates
Whole life	\$5,688,669	\$717,840	517
Endowment	1,570,000	691,865	386
Term life	4,579,449	100,760	272
Life paid up	3,206,121	1,702,203	1,650
20-payment life	3,501,000	224,231	302
Life Paid up @ 65	827,500	87,140	59
Paid-up additions ¹	3,536,719	1,329,725	0
Universal life	2,162,087	95,926	38
Annuities	261,380	250,900	23
Members			<u>24</u>
Total	<u>\$25,332,925</u>	<u>\$5,200,590</u>	<u>3,271</u>

¹Represents insurance from refunds (dividends).

III. MANAGEMENT AND CONTROL

Membership

FLIA consists of insured and social members associated together in groups. The society has eight lodges (groups), of which seven are active and meet regularly.

There are three classes of membership. An insured benefit member is an adult 18 years of age or older to whom a policy of insurance has been issued, or who receives a settlement agreement benefit from such insurance. These members are entitled to participate in the activities and hold office in the local group, and to vote for and be elected delegates to any convention. Second, are children who, upon the application of an adult may be issued insurance, and upon attainment of age 18 become a benefit member. Third, is a social benefit member. This non-insured class of member is a family or an adult 18 years or older who pays the required dues, but who may not vote on any matters pertaining to the affairs of the fraternal benefit society. A social member under the age of 18 may not vote on group affairs.

Growth of Membership

Year	Policies
1997	3,728
1998	3,655
1999	3,529
2000	3,393
2001	3,271

Convention

The society's supreme governing body is the convention. The convention is held every four years, with the most recent convention being held in September 2000 in Milwaukee, Wisconsin. The national convention is the legislative, judicial, and governing body of FLIA, and has authority to amend bylaws and the articles of incorporation. It may also make rules and regulations for the government of itself, the board of directors, the groups, and its members and beneficiaries.

The convention consists of delegates elected by their respective group. A delegate may be elected by a group for each 50 members, with each group entitled to at least one delegate. Only insured group dues-paying members are eligible to become delegates, and they must be members for 30 days and be of legal age. Only members present at a meeting of the local group to elect delegates may be elected, and unless an exception is given, members must have attended at least 50% of the local group meetings. A delegate cannot vote by proxy.

Board of Directors

The board of directors consists of nine members: the four director/officers of the society and five directors. The board of directors is elected by the convention to serve a four-year term effective October 1 of the year of the convention. The board holds regular monthly meetings at which it approves investments, mortgage loans, claims, general expenses, reports of the various committees, and other business of the society. The five-board members who are not officers currently receive \$400 per quarter for serving on the board.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Jeanette Holmquist Milwaukee, WI	Sr. Compensation Assistant	2004
Bruce Kaniewski Franklin, WI	Sr. Planner	2004
Jillain Thomas Milwaukee, WI	Legislative Assistant	2004
Constance Pravechek Oak Creek, WI	Secretary/Treasurer Federation Life	2004

Robert Ullenberg Milwaukee, WI	Retired	2004
Thomas Cetnarowski Cudahy, WI	Shipping/Receiving Supervisor	2004
Mary Golla Milwaukee, WI	Retired	2004
Helen Sokolowski Milwaukee, WI	Retired	2004
Robert Plaszkievicz Franklin, WI	Retired	2004

Officers of the Society

The officers serving at the time of this examination are as follows:

Name	Office	2001 Compensation
Jeanette Holmquist	President	\$8,559
Constance Pravechek	Secretary/Treasurer	51,214
Bruce Kaniewski	Vice President-male	800*
Jillian Thomas	Vice President-female	2,417

* Was elected vice president on January 1, 2003. Before that, Mr. Kaniewski was a non-officer member of the Board of Directors. The salary above is his 2001 compensation as director.

Committees of the Board

The society's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Executive Committee

Jeanette Holmquist, Chair
Bruce Kaniewski
Jillian Thomas
Constance Pravechek

Inspection Committee

Constance Pravechek, Chair
Thomas Cetnarowski
Robert Ullenberg

Financial Committee

Bruce Kaniewski, Chair
Jillian Thomas
Helen Sokolowski

Bylaw Committee

Constance Pravechek, Chair
Bruce Kaniewski
Robert Plaszkievicz
Thomas Cetnarowski
Jillian Thomas

Historian Committee

Mary Golla, Chair
Robert Ullenberg
Helen Sokolowski

Development Committee

Bruce Kaniewski, Chair
Robert Plaszkievicz
Constance Pravechek
Jillian Thomas
Thomas Cetnarowski
Robert Ullenberg
Helen Sokolowski
Mary Golla

Women's Division

Jillain Thomas, Chair
Constance Pravechek
Helen Sokolowski
Mary Golla

Human Development

Thomas Cetnarowski
Constance Pravechek
Jillain Thomas
Helen Sokolowski

Youth and Education

Jillain Thomas, Chair
Robert Ullenberg
Thomas Cetnarowski
Mary Golla

Nominating Committee

Bruce Kaniewski, Chair
Helen Sokolowski
Constance Pravechek

Scholarship Committee

Robert Plaszkievicz
Bruce Kaniewski
Constance Pravechek

Marketing Committee

Bruce Kaniewski, Chair
Thomas Cetnarowski
Jillian Thomas
Robert Plaszkievicz
Constance Pravechek

IV. REINSURANCE

Effective January 1, 1996, the society entered into three ceding reinsurance contracts with Optimum Re Insurance Company (Optimum Re). These contracts are unlimited in their duration. Optimum Re underwrites and reinsures all policies issued by FLIA effective January 1, 1996, except for annuities, simplified issue whole life, and the pour-in rider benefit. The pour-in rider benefit allows older members who purchased small certificates several years ago to apply for additional insurance without a medical examination if they are in good health and can answer medical questions on the application with a "no".

The coinsurance and yearly renewable term (YRT) reinsurance contracts are conditional automatic contracts. Policies must be submitted by the society to the reinsurer who underwrites each case. The reinsurer retains the right to refuse to reinsure the risk if it finds it is uninsurable by its standards. If accepted, then the automatic treaty conditions apply. Under both the coinsurance and YRT contracts, the society's retention is \$25,000. There is a minimum cession of \$1,000 for both contracts.

The coinsurance contract covers universal life and two renewable and convertible term plans. The maximum amount of reinsurance on a coinsurance basis is \$2,000,000 per life. Life amounts in excess of this amount are reinsured up to \$5,000,000 on a YRT basis. Ceding commission is 100% the first year. For renewal ceding commissions, term plans range from 5% to 20%, and universal life from 5% to 35%. Policies over \$2,000,000 and term riders receive no ceding commission.

The YRT contract covers life paid-up at 65, single premium, and two whole life plans. Premiums are at the reinsurer's rates, with no first-year premium. There is no ceding commission on life premium, except flat extra premium and waiver of premium is 75% the first year and 10% for renewals.

The third contract with Optimum Re is an automatic bulk reinsurance agreement covering individual accidental death benefit policies and riders. It covers all policies in force on or after January 1, 1996. The retention is \$0. Coverage for the maximum issue and participation

limits and the maximum per insured life is \$300,000. The annual premium per \$1,000 of insurance for ADB coverage is \$0.70, with no ceding commission.

Contracts with Business Men's Assurance Company of America (BMA) were terminated effective December 31, 1996, and are in runoff. All contracts in force and in runoff contained proper insolvency provisions. FLIA assumes no reinsurance.

V. FINANCIAL DATA

The following financial statements reflect the financial condition of the society as reported in the December 31, 2001, annual statement to the Commissioner of Insurance. Also included in this section are schedules which reflect the growth of the society, NAIC Insurance Regulatory Information System (IRIS) ratio results during the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Members' Surplus per Examination."

Federation Life Insurance of America
Assets
As of December 31, 2001

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	\$4,532,795	\$0	\$4,532,795
Stocks:			
Preferred stocks	50,435		50,435
Common stocks	430,324		430,324
Mortgage loans on real estate:			
First liens	857,043		857,043
Real estate:			
Occupied by the society	363,719		363,719
Certificate loans and liens	302,524		302,524
Cash	20,874		20,874
Electronic data processing equipment and software	16,640	16,640	0
Life premiums and annuity considerations deferred and uncollected	1,547		1,547
Investment income due and accrued	90,953		90,953
Other assets nonadmitted:			
Furniture and equipment	<u>2,625</u>	<u>2,625</u>	<u>0</u>
Total Assets	<u>\$6,669,479</u>	<u>\$19,265</u>	<u>\$6,650,214</u>

Federation Life Insurance of America
Liabilities, Surplus, and Other Funds
As of December 31, 2001

Aggregate reserve for life certificates and contracts	\$5,220,690
Liability for deposit-type contracts	58,974
Certificate and contract claims:	
Life	34,198
Provision for refunds payable in following calendar year:	
Apportioned for payment to December 31, 2002	97,000
Premiums and annuity considerations received in advance	66,250
Certificate and contract liabilities not included elsewhere:	
Interest maintenance reserve	31,340
Commissions to fieldworkers due or accrued	810
General expenses due or accrued	15,736
Taxes, licenses, and fees due or accrued	275
Amounts withheld or retained by society as agent or trustee	8,394
Miscellaneous liabilities:	
Asset valuation reserve	<u>89,934</u>
Total Liabilities	5,623,601
Unassigned funds (surplus)	<u>1,026,613</u>
Total Surplus	<u>1,026,613</u>
Total Liabilities, Surplus, and Other Funds	<u>\$6,650,214</u>

Federation Life Insurance of America
Summary of Operations
For the Year 2001

Premiums and annuity considerations for life and accident and health policies and contracts	\$245,940
Net investment income	334,815
Amortization of interest maintenance reserve	(1,099)
Commissions and expense allowances on reinsurance ceded	3,002
Miscellaneous income:	
Write-ins for miscellaneous income:	<u>150</u>
Total income items	<u>582,808</u>
Death benefits	168,589
Matured endowments	31,630
Disability, accident and health benefits including premiums waived	202
Surrender benefits and withdrawals for life contracts	106,035
Interest and adjustments on certificate or deposit-type contract funds	2,321
Increase in aggregate reserve for life and accident and health certificates and contracts	<u>75,894</u>
Subtotal	384,671
Commissions on premiums, annuity considerations, and deposit-type contract funds	4,102
General insurance expenses and fraternal expenses	314,707
Insurance taxes, licenses, and fees	15,334
Increase in loading on deferred and uncollected premiums	<u>(24)</u>
Total deductions	<u>718,790</u>
Net gain from operations before refunds to members	(135,982)
Refunds to members	<u>89,469</u>
Net gain from operations after refunds to members and before realized capital gains or (losses)	(225,451)
Net realized capital gains or losses	<u>(13,220)</u>
Net Income	<u><u>\$(238,671)</u></u>

Federation Life Insurance of America
Cash Flow
As of December 31, 2001

Premiums and annuity considerations for life and accident and health policies and contracts	\$260,109	
Net investment income	383,987	
Commissions and expense allowances on reinsurance ceded	3,002	
Write-ins for miscellaneous income:		
Mortgage Service Fees	<u>150</u>	
Total		\$647,248
Death benefits	162,920	
Matured endowments	20,197	
Disability, accident and health benefits	202	
Surrender benefits and withdrawals for life contracts	106,035	
Interest and adjustment on certificates or deposit-type contract funds	<u>2,321</u>	
Subtotal	291,675	
Commissions on premiums, annuity considerations and deposit-type contract funds	4,070	
General insurance expenses and fraternal expenses	311,811	
Insurance taxes, licenses and fees	15,169	
Refunds to members paid	<u>89,469</u>	
Total deductions		<u>712,194</u>
Net cash from operations		\$(64,946)
Proceeds from investments sold, matured, or repaid:		
Bonds	760,668	
Stocks	1,189,180	
Mortgage loans	<u>206,475</u>	
Total investment proceeds		2,156,323
Cost of investments acquired (long-term only):		
Bonds	932,115	
Stocks	1,351,320	
Mortgage loans	92,000	
Real estate	<u>2,177</u>	
Total investments acquired		2,377,612
Net increase (or decrease) in certificate loans and liens		<u>13,565</u>
Net cash from investments		(234,854)
Cash applied for financing and miscellaneous uses:		
Withdrawals on deposit-type contract and other		
Liabilities without life or disability contingencies	7,484	
Other applications	<u>9,606</u>	
Total		<u>17,090</u>
Net cash from financing and miscellaneous sources		<u>(17,090)</u>
Net change in cash and short-term investments		(316,890)

Reconciliation

Cash and short-term investments, December 31, 2000

337,764

Cash and short-term investments, December 31, 2001

\$ 20,974

Federation Life Insurance of America
Compulsory and Security Surplus Calculation
December 31, 2001

Assets		\$6,650,214	
Less liabilities		<u>5,623,601</u>	
Adjusted surplus			\$1,026,613
Annual premium:			
Individual life and health (less refund to members)	170,641		
Factor	<u>15%</u>		
Total		\$ 25,596	
Greater of 7.5% of considerations or 2% of reserves for annuities and deposit administration funds		<u>5,228</u>	
Compulsory surplus			<u>30,824</u>
Compulsory surplus excess or (deficit)			<u>\$995,789</u>
Adjusted surplus			\$1,026,613
Security surplus:			
(140% of compulsory surplus, factor reduced 1% for each \$33 million in premium written in excess of \$10 million with a minimum of 110%)			<u>43,153</u>
Security surplus excess or (deficit)			<u>\$983,460</u>

**Federation Life Insurance of America
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2001**

The following schedule is a reconciliation of total surplus during the period under examination as reported by the society in its filed annual statements:

	1997	1998	1999	2000	2001
Surplus, beginning of year	\$1,434,231	\$1,472,294	\$1,387,770	\$1,330,199	\$1,262,465
Net income	13,584	(165,683)	(24,436)	(39,665)	(238,671)
Change in net unrealized capital gains or (losses)	82,598	68,039	(18,055)	(28,505)	(50,595)
Change in nonadmitted assets and related items	(1,501)	1,501	(20,006)	(719)	1,460
Change in asset valuation reserve	(55,812)	11,619	4,926	10,330	51,954
Write-ins for gains and (losses) in surplus:					
Change in Reserve for Convention Expense	(809)				
Rounding	3				
Prior Year Fund Adjustment				(9,175)	
Surplus, end of year	<u>\$1,472,294</u>	<u>\$1,387,770</u>	<u>\$1,330,199</u>	<u>\$1,262,465</u>	<u>\$1,026,613</u>

**Federation Life Insurance of America
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2001**

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination. Exceptional ratios are denoted with asterisks. A

discussion of the exceptional ratios may be found after the IRIS ratios.

Ratio	1997	1998	1999	2000	2001
#1 Net change in surplus	7.0%	-10.0%*	-4.0%	-5.0%	-19.0%*
#2 Net income to total income	11.0	-25.0*	3.0*	-6.0*	-42.0*
#3 Comm and Exp to Prem and Deposits	Discontinued				
#4 Adequacy of investment income	214.0	216.0	190.0	181.0	173.0
#5 Non-admitted to admitted assets	0.0	0.0	0.0	0.0	0.0
#6 Total real estate & mortgage loans to cash & invested assets	22.0	20.0	22.0	20.0	19.0
#7 Total affl investments to surplus	0.0	0.0	0.0	0.0	0.0
#8 Surplus relief	0.0	0.0	0.0	0.0	0.0
#9 Change in premium	-23.0*	-25.0*	-1.0	-6.0	5.0
#10 Change in product mix	9.9*	0.4	0.2	0.0	0.0
#11 Change in asset mix	2.5	1.0	0.9	0.5	0.9
#12 Change in reserving ratio	-39.0*	43.0*	-14.0	-6.0	-3.0

Ratio Number 1 measures the improvement or deterioration in the society's financial condition during the year. This ratio was exceptional in 1998 and 2001. It appears the ratio fell outside

the normal limits due to the underwriting losses in those years. In 1998, the loss was attributed to decreased sales due to the loss of a sales person, decrease in net investment income, and completely expensing the society's computer software. In 2001, the society continued to see decreases in premium written as well as decreased investment income due to adverse market conditions.

Ratio Number 2 is a conservative measure of the society's profitability. It identifies reporting losses and/or developing loss trends. The society reported exceptional ratios in 1998, 1999, 2000 and 2001. The exceptional results appear to be due to the net losses the society sustained in those years. The society's net losses from 1998 through 2001 were \$186,341, \$98,071, \$138,340 and \$225,451 respectively. The society attributes its net loss in operations to less premium writings. In addition the unfavorable market in 2001 attributed to the losses in that year.

Ratio Number 9 is the percentage change in premiums from the prior year. It is designed to detect rapid premium increases or decreases. This ratio was exceptional in 1997 and 1998 due to a substantial decrease in new annuity business in comparison to 1996.

Ratio Number 10 represents the average change in the percentage of total premium for each product line during the year. The exceptional result in 1997 is related to the dramatic fall in new annuity business in comparison to 1996.

Ratio Number 12 tests for the changes in reserving on life insurance in relation to increases in the aggregate life mortality reserves. This ratio was exceptional in 1997 and 1998, due to the dramatic fall in new annuity business in comparison to prior years.

Growth of Federation Life Insurance of America

Year	Admitted Assets	Liabilities	Members' Surplus
1997	\$6,586,705	\$5,114,411	\$1,472,294
1998	6,719,989	5,332,219	1,387,770
1999	6,816,201	5,486,002	1,330,199
2000	6,801,325	5,538,860	1,262,465
2001	6,650,214	5,623,601	1,026,613

Life Insurance In Force (in thousands)

Year	Gross Direct and Assumed	Ceded	Net
1997	\$24,260	\$4,223	\$20,037
1998	25,027	5,017	20,010
1999	25,157	4,822	20,335
2000	25,107	5,138	19,969
2001	25,072	4,828	20,244

As illustrated above, the society has declining surplus over the five year period. The society indicates that over the past three years, FLIA has relocated its home office and was unable to maintain a full time salesperson on staff, which created a setback for the society. In addition, the society's poor performance in 2001 was also the result of adverse market trends. The society currently has a sales person and is taking steps to write new policies, however the society has no business plan that outlines what steps it plans to take. This is discussed further in the section of this report captioned "Summary of Current Examination Results."

Reconciliation of Members' Surplus per Examination

There were no adjustments to surplus or reclassifications as a result of the examination.

VI. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were fifteen specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the society are as follows:

1. Business Plan and Budget— It is recommended that the society annually prepare a budget, that there be a comparison of projected to actual amounts for the budget and the business plan, and that management and the board of directors annually review the business plan and the financial projections, with annual adjustments made as needed. It is also recommended that the society consider the possibilities for merger with another fraternal, since declining membership continues to make operations increasingly unprofitable as a separate entity.

Action—Noncompliance, see comments in Summary of Current Examination Results

2. Corporate Records—It is recommended that all executive committee meetings and actions be reported at the board of directors meetings, that the board of directors minutes indicate the approval of the purchase and sale of investments, and that all committees appointed or approved by the board have minutes of their meetings.

Action—Partial Compliance, see comments in Summary of Current Examination Results.

3. Lodges—It is recommended that the society establish follow-up procedures to assure that all lodges send in yearly completed activity reports, and that the society consider combining or eliminating inactive lodges so the society is in compliance with ch. 614, Wis. Stat.

Action—Partial Compliance, see comments in Summary of Current Examination Results

4. Safekeeping Agreement and Investment Guidelines—It is again recommended that the society hold securities under a proper custodial agreement with the language required by the NAIC Examiners Handbook for the necessary safeguards and controls, and which has been signed by all the parties.

Action—Compliance

5. Safekeeping Agreement and Investment Guidelines—It is recommended that the society request that the investment agency agreement with the trust company be amended to give the society detailed notification of an investment transaction within five business days of the date of the transaction.

Action—Compliance

6. Safekeeping Agreement and Investment Guidelines—It is recommended that written investment guidelines be prepared and given to the trust company upon approval by the board of directors.

Action—Compliance

7. Accounts and Records—It is recommended that the society complete Schedule M, Parts 1 and 2 of the annual statement for refunds in accordance with the NAIC Annual Statement Instructions-Fraternal.

Action—Compliance

8. Accounts and Records—It is recommended that the society correct the deficiencies noted, and complete future annual and quarterly statements in accordance with the NAIC Annual Statement Instructions-Fraternal and the Accounting Practices and Procedures Manual.

Action—Compliance

9. Certificate Loans and Liens—It is again recommended that the society annually calculate the cash surrender value for all loans, and that the excess of any loan balance that exceeds the cash surrender value be nonadmitted in accordance with the NAIC Annual Statement Instructions-Fraternal.

Action—Compliance

10. Cash and Short-term Investments—It is recommended that the society report money market funds in the proper schedule(s) of the annual statement in accordance with the NAIC Annual Statement Instructions-Fraternal and the Purposes and Procedures manual of the Securities Valuation Office.

Action—Compliance

11. Life Insurance Premiums and Annuity Considerations Deferred and Uncollected—It is recommended that the society automate their premium billing and collection system in order to provide accurate and timely monthly premium reports and documentation to support premium balances, and that procedures be written for the collection of all past due premium.

Action—Partial Compliance, see comments in Summary of Current Examination Results.

12. Premiums and Annuity Considerations Received in Advance, and Liability for Premium and Other Deposit Funds—It is recommended that the society prepare monthly automated reports with written procedures for accurate determination by policy of advance premium payments, deposits, and balances pursuant to s. 601.42, (1g) (a), Wis. Stat.

Action—Compliance

13. Aggregate Reserve for Life Certificates and Contracts—It is again recommended that the society establish controls to assure that proper in-force amounts and reserve valuation be reported pursuant to the NAIC Annual Statement Instructions-Fraternal, and that they be adjusted for all reported death claims.

Action—Partial Compliance, see comments in Summary of Current Examination Results.

14. Remittances and Items Not Allocated—It is recommended that the society comply with ch. 177, Wis. Stat., as regards the proper reporting of unclaimed funds, and that funds for life and endowment policies which have been unclaimed after one year be shown as a separate write-in line in future statutory annual statements.

Action—Compliance

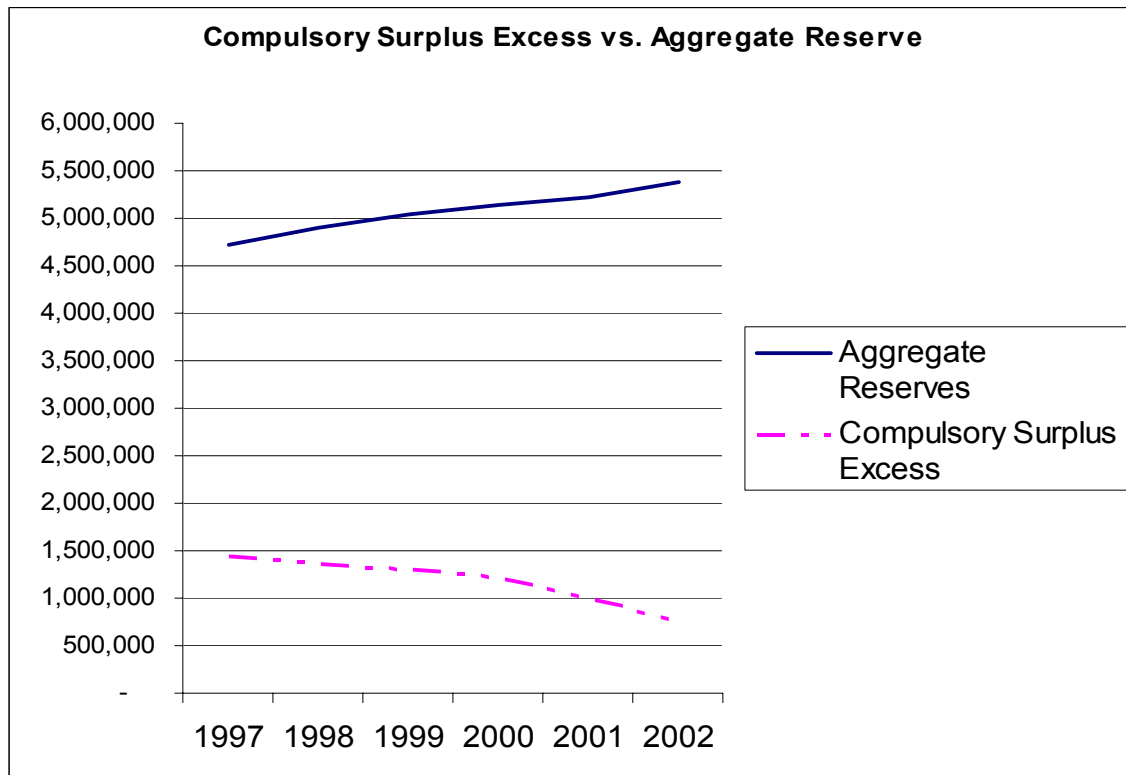
15. Commissions to Fieldworkers Due or Accrued—It is recommended that commissions be paid in accordance with the agent's contract and commission schedule, and not before the premium has been paid.

Action—Compliance

Summary of Current Examination Results

Business Plan and Budgets

The last two examination reports recommended the society develop a business plan and annually prepare a budget. A business plan was started at the time of the last examination but was never finished. At the time of this examination there is no business plan or budget in place. A business plan coupled with a budget is a tool used by the management of the society to determine its position in the market. In the case of FLIA, its surplus position decreased each year for the period under examination. This would not be an issue if the society's obligations to policyholders were declining at a pace to commensurate with the decline in surplus. If the surplus and policyholder obligations were declining at an equal pace, the projection of future surplus and policyholder obligations would result in surplus approaching zero just as the last of the policyholder obligations were paid. However, FLIA's surplus has been decreasing while its policyholder obligations have been increasing. Following this section is a chart of FLIA's compulsory surplus excess relative to aggregate reserves for the period under examination and a schedule showing the company's declining compulsory surplus excess for the examination period. Should this trend continue, FLIA will have a deficiency in compulsory surplus in three to four years. A compulsory surplus excess is required in order to not be considered in financially hazardous condition pursuant to s. 623.11, Wis. Stat. It is recommended that the society develop a plan to address the declining compulsory surplus excess relative to aggregate reserves and file this plan with the commissioner within six months of the adoption of this report. In addition, the society should prepare an annual budget and periodically monitor comparisons from budgeted to actual.



SCHEDULE OF COMPULSORY SURPLUS

	1997	1998	1999	2000	2001	2002
Assets	6,586,705	6,719,989	6,816,201	6,801,325	6,650,214	6,511,813
Less Liabilities	5,114,411	5,332,219	5,486,002	5,538,861	5,623,601	5,713,714
Adjusted Surplus	1,472,294	1,387,770	1,330,199	1,262,464	1,026,613	798,099
Annual premium(less refunds to Members)	219,939	200,694	201,246	183,697	170,641	172,312
Factor	0.15	0.15	0.15	0.15	0.15	0.15
Total	32,991	30,104	30,187	27,555	25,596	25,847
Amount of Reserve for Annuities and Deposit Administration funds	228,836	247,443	259,844	269,141	261,380	347,245
Factor	0.02	0.02	0.02	0.02	0.02	0.02
	4,577	4,949	5,197	5,383	5,228	6,945
Greater of 7.5% or 2% of reserves for annuities and deposit administration funds	4,577	4,949	5,197	5,383	5,228	6,945
Compulsory Surplus	37,568	35,053	35,384	32,938	30,824	32,792
Compulsory excess or (deficit)	1,434,726	1,352,717	1,294,815	1,229,526	995,789	765,307

Corporate Records

The last examination recommended that all executive committee meetings and actions be reported at the board of directors meetings, that the board of directors' minutes indicate the approval of the purchase and sale of investments, and that all committees appointed or approved by the board have minutes of their meetings. Review of the board of director minutes during the current examination noted the board approves investment sales and purchases and the committees report to the board. However, there are no minutes to the committee meetings. Therefore, the society had partially complied with the prior examination recommendation. It is again recommended that all committees appointed or approved by the board have minutes of their meetings.

Lodges

The last examination recommended that the society establish follow-up procedures to assure that all lodges provide yearly completed activity reports, and that the society consider combining or eliminating inactive lodges so the society is in compliance with ch. 614, Wis. Stat. The current examination determined partial compliance to the recommendation since the society had consolidated from 26 lodges of which twelve were active to eight lodges, where seven are active. It is again recommended that the society consider combining or eliminating inactive lodges so the society is in compliance with ch. 614, Wis. Stat.

Corporate Insurance Coverage

The NAIC Financial Condition Examiners' Handbook outlines suggested minimum fidelity bond coverage for insurance companies. For a society with the amount of assets and premiums as FLIA the suggested minimum amount of fidelity coverage would be \$75,000. The society currently has \$10,000 of coverage for Employee dishonesty in its businessowners package policy. The society indicated that this coverage was provided for in its Directors and Officers Liability policy. Review of this policy indicated that it did not include the adequate type of coverage for employees. It is recommended that the society obtain blanket employee dishonesty insurance (i.e., fidelity bond) in at least the \$75,000 minimum amount as suggested by the NAIC Financial Condition Examiners' Handbook.

Certificate Loans

Testing of the society's certificate loan report noted the following deficiencies:

- Running Subsystem/General Ledger balancing difference (approx. \$1000) exists
- Certificate Loan Trial Balance does not identify the last payment amount
- Cash Value for Policy form does not identify the loan balance based on an "as of date inquiry"
- Interest calculations appear to result in immaterial reporting differences due to rounding which may in part be related to the running system difference

The society has been working with its actuary to address the system differences. It is recommended the society continue to address the deficiencies noted above and write-off undeterminable differences and establish a clean reconciling point going forward.

Mortgage Loans

The society uses an Inspection of Property and Approval Form when approving mortgage loans. The Inspection of Property is to be signed by applicable inspection committee members participating in the onsite review. The approval is to be signed by the Secretary/Treasurer and documented by the Board of Director's acceptance and approval at the designated Board meeting date. This approval was unsigned for three loans and not present for three other loans in the sample. Further testing documented that in one instance the board minutes indicated an amount approved of \$90,000 for a loan disbursed for \$92,000. The society's treasurer indicated that the original loan approved amount was apparently increased to meet the minimum payout requirements, which were subsequently determined to be slightly higher. It is recommended that the society consistently complete the Approval Form to document approval in accordance with its internal procedures as well as approving all changes in loan amounts with its board of directors.

Schedule D

Review of the society's Schedule D in the annual statement filed for the year ended December 31, 2001, found a number of items that were not completed correctly. These are outlined below:

- The effective rate used to calculate the amortization of the bond premium and discount was not reported correctly on the company's Schedule D. Testing

provided that the society was using the scientific method as required by Statement of Statutory Accounting Principles (SSAP) No. 26 in completing the schedule.

- The society had incorrectly used the Z rating for a security that was acquired in November of 1999. The society should have reported this as a PE and retained the proper documentation. The rating for this security has been corrected as of December 31, 2002.
- The society is reporting an Oregon State security on its Schedule D as a 1PE. Detail was requested on the securities rating. The documentation received included ratings for all other Oregon State securities and their PE rating. It was noted that since all other Oregon State securities were 1PE this one could be assumed to be also. The Purposes and Procedures manual of the NAIC Securities Valuation Office is specific in saying that documentation must be available showing the NRSRO rating that would support the PE rating. Providing documentation on other securities does not meet this requirement.

It is recommended the society complete its Schedule D correctly in future annual statements in accordance with the NAIC Annual Statement Instructions-Fraternal and the Purposes and Procedures Manual of the NAIC Securities Valuation Office.

Aggregate Reserve for Life Certificates and Contracts

The prior two examinations recommended that the society establish controls to assure that proper in-force amounts and reserve valuations be reported pursuant to the NAIC Annual Statement Instructions-Fraternal, and that they be adjusted for all reported death claims. Testing completed on the examination noted that the society does not remove policyholders from the In-Force listing until the claim has been paid. In addition it was noted it does not record a liability for the interest that will be paid to the beneficiary. The society only records a liability for the face value of the policy. It is again recommended the society establish controls to assure the proper in-force amounts and reserve valuation be reported pursuant to the NAIC Annual Statement Instructions-Fraternal.

The society currently holds an incurred but not reported (IBNR) reserve of \$4,000. This reserve is a set dollar amount used by the society and was established after the last examination. Due to the size of the society, it would seem appropriate that a set dollar amount would be reasonable. However, during the current examination period the IBNR was understated. Since the majority of certificates are around \$1,000 this may be appropriate, however, one \$5,000

certificate would understate the liability. It is recommended that the society establish a procedure to determine the reasonableness of its IBNR estimate.

Life Insurance Premiums and Annuity Considerations Deferred and Uncollected

The last examination recommended that the society automate its premium billing and collection system in order to provide accurate and timely monthly premium reports and documentation to support premium balances, and that procedures be written for the collection of all past due premiums. The society's premium system is now automated and premium reports were provided for all months in 2001. For amounts past due it is the society's policy to place the certificate on extended term if the premium is not paid after three months. It was determined that the society was not consistently placing policies on extended term in accordance with its policy. It is recommended the society place certificates on extended term in accordance with its policy.

Funds on Deposit

The liability for deposit type contracts consisted of funds held and advance premium discount. In reconciling the detail to the annual statement it was discovered there was an immaterial variance between the detail provided from the society's computer system and the amount reported on the annual statement. In addition, the interest accrued for the advance premium discount portion of the liability was not being calculated at the correct rate. At year-end the society's actuary had recalculated the advance premium discount using the correct rate. However, even after receiving this recalculation, the amount still did not reconcile to the annual statement. There were also a number of policies that should not have been included on the report. The society is currently working on reconciling this account to ensure its accuracy. Furthermore, according to the SSAP No. 51 and No. 52, Advance Premium Discount would also be more appropriately classified on the Advance Premium line item of the annual statement. Traditionally, the Advance Premium Discount was considered a premium deposit and reported in the line item for Deposit Type contracts. However, SSAP no. 51 states any premium received in advance is advance premium and it was concluded this amount should be in advance premium, because there is not a separate contract. It is recommended the society reconcile this account in

order to report the correct number, and report only the funds on deposit of this liability in Deposit type contracts in accordance with SSAP No. 52.

Advance Premium

The society is currently reporting the Unearned Premium Reserve in the line item "Advance Premium" on the annual statement. It has been determined this reserve would be more appropriately classified as a write-in on Exhibit 8. In addition, the examiners determined that the amounts reported as Unearned and Advance Premium on the detail report were incorrect. There was a system error that led to the overstatement of this liability. The actuary reran the numbers and reported an immaterial overstatement as a result. In addition, the Advance Premium was overstated due to the fact the third quarter's numbers were reported on the annual statement. It is recommended the society correctly report its Unearned Premium Reserve and Advance Premium in accordance with SSAP No. 51.

Exhibit of Life Insurance

The company did not report on the Exhibit of Life Insurance, the amount of Insurance ceded as required by the NAIC Annual Statement Instructions – Fraternals for the years 1998, 1999, 2000, and 2001. It is recommended the society complete the Exhibit of Life Insurance in accordance with the NAIC Annual Statement Instructions – Fraternals.

VII. CONCLUSION

Federation Life Insurance of America's 2001 statutory annual statement reported assets of \$6,650,214, liabilities of \$5,623,601 and members' surplus of \$1,026,613. The society reported a net loss of \$238,671.

The society's surplus has been decreasing for the last four years due to four consecutive years of net losses. The society has no business plan to address its continuing deteriorating financial condition. The last two examination reports recommended the society annually prepare a budget and develop a business plan. The society had started the development process of business plan, but it was never completed. The current examination again recommends that the society prepare a business plan for monitoring a compulsory surplus excess.

The society did not comply with one prior examination recommendation and partially complied with four prior examination recommendations. The current examination resulted in thirteen recommendations as summarized in "Summary of Comments and Recommendations" section of this report. No adjustments to surplus or reclassifications were made.

VIII. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 24 - Business Plan and Budgets—It is recommended that the society develop a plan to address the declining compulsory surplus excess relative to aggregate reserves and file this plan with the commissioner within six months of the adoption of this report. In addition, the society should prepare an annual budget and periodically monitor comparisons from budgeted to actual.
2. Page 26 - Corporate Records—It is again recommended that all committees appointed or approved by the board have minutes of their meetings.
3. Page 26 - Lodges—It is again recommended that the society consider combining or eliminating inactive lodges so the society is in compliance with ch. 614, Wis. Stat.
4. Page 26 - Corporate Insurance Coverage—It is recommended that the society obtain blanket employee dishonesty insurance (i.e., fidelity bond) in at least the \$75,000 minimum amount as suggested by the NAIC Financial Condition Examiners' Handbook.
5. Page 27 - Certificate Loans—It is recommended the society continue to address the deficiencies noted above and write-off undeterminable differences and establish a clean reconciling point going forward.
6. Page 27 - Mortgage Loans—It is recommended that the society consistently complete the Approval Form to document approval in accordance with its internal procedures as well as approving all changes in loan amounts with its board of directors.
7. Page 28 - Schedule D—It is recommended the society complete its Schedule D correctly in future annual statements in accordance with the NAIC Annual Statement Instructions-Fraternal and the Purposes and Procedures Manual of the NAIC Securities Valuation Office.
8. Page 28 - Aggregate Reserve for Life Certificates and Contracts—It is again recommended the society establish controls to assure the proper in-force amounts and reserve valuation be reported pursuant to the NAIC Annual Statement Instructions-Fraternal.
9. Page 29 - Aggregate Reserve for Life Certificates and Contracts—It is recommended that the society establish a procedure to determine the reasonableness of its IBNR estimate.
10. Page 29 - Life Insurance Premiums and Annuity Considerations Deferred and Uncollected—It is recommended the society place certificates on extended term in accordance with its policy.
11. Page 29 - Funds on Deposit—It is recommended the society reconcile this account in order to report the correct number, and report only the funds on deposit of this liability in Deposit type contracts in accordance with SSAP No. 52.
12. Page 30 - Advance Premium— It is recommended the society correctly report its Unearned Premium Reserve and Advance Premium in accordance with SSAP No. 51.

13. Page 30 - Exhibit of Life Insurance—It is recommended the society complete the Exhibit of Life Insurance in accordance with the NAIC Annual Statement Instructions – Fraternals.

IX. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the society is acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, state of Wisconsin, participated in the examination:

Name	Title
Tom Janke	Insurance Financial Examiner

Respectfully submitted,

Danielle C. Rogacki
Examiner-in-Charge